Abbott Out Of His Depth On Mining

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Does Tony Abbott understand the Australian mining sector? His inept response to the Olympic Dam announcement showed him mangling the basics of public policy, writes Ian McAuley.

Last week BHP-Billiton announced that their profit had fallen from $US32 billion in 2010-11 to a mere $US27 billion last year, and that they were shelving their $30 billion Olympic Dam expansion. Tony Abbott's commentary on the event exposed him as an Opposition Leader way out of his depth and brought forth confusing statements about the progress of the resource boom.

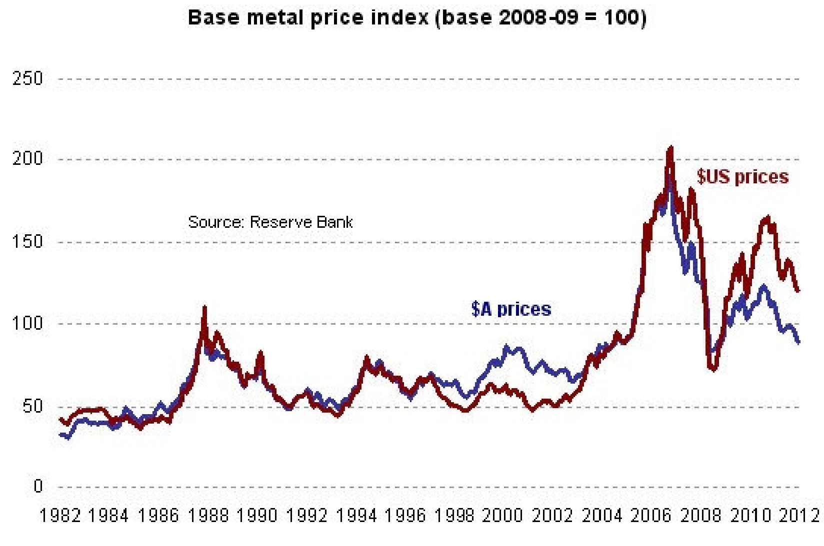
Abbott's claim that the carbon tax and the minerals resource rent tax (MRRT) were behind the decision to drop the Olympic Dam expansion was quite at odds with the company's announcement that the decision was about capital construction costs and "subdued commodity prices".

The resources at Olympic Dam are uranium, copper and gold, none of which is subject to the MRRT. If anything, global action on climate change should have been expected to boost uranium demand, but the price of uranium oxide has fallen from a peak of $US290/kg in 2007 to around $US110 now, the Fukushima accident and the tumbling price of gas and photovoltaics having dampened any expectation of a price recovery.

Even if Abbott hadn't read the company statement, he could have scored a partisan point by blaming environmentalists for damaging the reputation of uranium. Or is he is so ignorant of the Australian economy that he does not know that Australia has the world's largest known uranium deposit at Olympic Dam? Had he read the statement he could have focussed on the poor performance of the company's metallurgical coal mining in Queensland, which has been subject to a long dispute between management and the unions. A conservative politician of Peter Reith's calibre would surely have been able to lay some of the blame on the Government's Fair Work Act. A specious argument is better than plain ignorance.

The second absurdity to do with the BHP-Billiton announcement was the ABC's beat-up of an apparent contradiction between Resources Minister Martin Ferguson and Finance Minister Penny Wong over the progress of the resource boom. This is almost certainly about the ABC's obsession with "balance" — if Abbott makes an idiot of himself, then the ABC feels obliged to find some negative aspect of the government's performance.

There was no contradiction, however, because Ferguson and Wong were talking about completely different matters. A resource boom isn't some homogenous economic process. Rather, it has several phases, and the two ministers were talking about different phases.



The first phase of a resource boom is usually a rapid rise in commodity prices, this time triggered by China's rapid growth. Demand runs ahead of production capacity, and prices of mineral commodities rise rapidly.

There is a lag in the supply response because it takes time to re-open mothballed mines and to develop new mines, but as supply rises prices peak and then commence a steady decline. Once capital has been sunk into a mine companies compete on the basis of ongoing costs, and prices stay depressed until there is another demand-supply imbalance, usually many years down the track.

In the present resource boom the price peak is well behind us. Contrary to popular opinion, it was the Howard government in its last term, not the present government, that enjoyed the boost in metal prices. Base metal prices started to rise in 2005, and peaked in mid-2007. They fell sharply during the 2008 crisis, and rose again but only to resume their falling trajectory.

In earlier booms the Australian dollar has tended to track commodity prices upwards and downwards, but this time our dollar has stayed high as commodity prices have fallen, because Australia, with its strong economy, low government debt and cautious fiscal management, has come to be seen as a safe haven for parking currency reserves. For mining companies the enduring high value of the Australian dollar is worsening the price effect. A politician with economic nous might blame our "balanced budget" obsession, but that would require the Coalition to reverse its puerile and patronising rhetoric on government debt.

While prices may have peaked, the investment phase still has a long way to run. The ABS estimates that there is more than $170 billion of private investment in the pipeline, of which two thirds is in the mining sector. This is most sharply illustrated in the case of engineering work associated with the mining sector, which has risen very sharply over the last few years. There may be some flattening as shown in the graph below, but it would have to fall dramatically to allow one to say the boom is over. It should be noted that the ABS estimates are very conservative: some private surveys (which do not reveal their methodology), suggest there is up to $900 billion in the investment pipeline. In particular, there should be strong ongoing investment in liquefied natural gas projects, which take longer to ramp up than mining projects.

Value of private sector engineering work yet to be done
in oil, gas, coal, other minerals and harbours $bn

Even once investment and engineering work eventually peak, the production phase of mining will expand for some time. As Reserve Bank Governor Glenn Stevens said on Friday, resource export shipments should pick up. The production phase of the boom has a long way to run. If some confidence returns to the European and American currencies, our exchange rate should fall, improving Australian dollar prices. Unless there is an extraordinary recovery in Europe and the USA, prices will not recover to their peak levels, but they will still be high. In the production phase, once construction has wound back, mining employment could fall, but it should be remembered that mining itself employs less than 2 per cent of Australia's workforce.

The construction sector however, which employs almost 9 percent of our workforce, could experience reduced activity in the mining sector as investment slows. There are significant backlogs in public infrastructure in areas such as public transport, railroads, roads and environmental restoration. Provided Australia practises sound counter-cyclical demand management, and isn't gripped by some "small government" ideology, those same resources could be employed to much needed provision of community infrastructure.

There will undoubtedly be more announcements of project cancellations and deferrals. In a boom there is always a gung-ho spirit of over-confidence in its early stages. Planners tend to overlook likely bottlenecks, construction cost rises, exchange rate effects and the behaviour of competitors. They make unrealistic projections about demand and prices. There is also a degree of strategic behaviour, as some companies stake claims in an effort to put off potential local or overseas competitors. Undoubtedly, when such cancellations and deferrals occur, opposition politicians will try to sheet home blame to the government of the day — that's the nature of politics.

Abbott's comments, however, were not those of a competent, well-briefed opposition leader. Senator Arthur Sinodinos tried to excuse his performance as one of the normal stumbles that busy people make when under stress. We all experience such stumbles — a slipped word, a forgotten figure, a mistaken name. Abbott's performance was no mere stumble, however: it was the behaviour of one who is out of his depth on issues of public policy. He showed that he knew little of Australia's mining industry, and that he lacked the judgement to ask for a brief, perhaps from shadow Minister Ian Macfarlane or one of his staff.

Whatever one's partisan perspective, these are not the qualities that give confidence in someone aspiring to be prime minister — a task which demands a great deal of knowledge and capacity to discuss complex policy issues. In view of the Coalition's strong showing in opinion polls potential investors must be far more worried by the behaviour of our possible next prime minister than they are about our well-grounded tax regime.

Disclosure: The author holds shares in BHP-Billiton.